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In The

Supreme Court of the United States

October Term, 1992

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.,

Petitioner,

v.

JOHN B. CAMP, TRUSTEE, SECURITIES INVESTOR PROTECTION CORPORATION,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

MOTION TO FILE BRIEF OF AMICUS CURIAE AND BRIEF OF AMICUS CURIAE AMERICAN INSURANCE ASSOCIATION IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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I. INTEREST OF AMICUS CURIAE

The American Insurance Association is a trade association with over two hundred and fifty members and representation in every state. The members of AIA are major property/casualty insurers, and include most of the largest writers of fidelity bonds in the United States.

Under the express terms of the fidelity bond at issue here, the bond unquestionably does not cover a loss for which the government, acting through the Securities Investor Protection Corporation ("SIPC"), seeks coverage. Upon application of the SIPC, the lower courts held invalid the contractual provision of the insuring agreement that precludes coverage, and entered a judgment for $500,000 (the full amount of the bond) against the insurer. The judgment, if affirmed, would be used to pay claims that otherwise would be paid from a fund maintained by SIPC and mandated by Congress.

AIA and its members are gravely concerned about the prospect of governmental and judicial rewriting of lawful and unambiguous insurance contracts in the government's self-interest. In this instance, the rewrite would impose liability upon an insurer under circumstances where the contracting parties had plainly agreed there would be no coverage.

II. NEED FOR ADDITIONAL BRIEFING

Petitioner argues that the lower courts misconstrued the relevant federal statutes and decisional law. AIA believes, in addition, that the government's action raises an important constitutional issue that has not been briefed by petitioner.

AIA respectfully moves for leave to file the attached brief amicus curiae, which addresses the constitutional issue, as well as statutory issues not briefed by petitioner.

The consent of the attorneys for respondent was requested but refused.

Dated: January 7, 1993.

Respectfully submitted,

SEDGWICK, DETERT, MORAN & ARNOLD

By _____

FREDERICK D. BAKER
Attorney for Amicus Curiae American Insurance Association

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BRIEF OF AMICUS CURIAE AMERICAN INSURANCE ASSOCIATION

I. INTRODUCTION AND SUMMARY OF ARGUMENT

This is an action to recover on a fidelity bond written by National Union to protect GSC, a securities dealer, from losses caused by dishonest acts of GSC's officers and employees.

A fidelity bond is a unique instrument, entirely unlike a commercial lease, or an agreement to provide goods or services, or any other routine business contract. One who issues a fidelity bond to a financial institution such as a bank, a savings and loan, or a securities dealer, does so on the basis of a very subjective assessment of the integrity of those who control the institution. Risk is calculated based on the insurer's trust in the honesty of the officers of the institution, and their ability to hire trustworthy employees and to carefully supervise their work.

Because the agreement is so closely tied to the insurer's trust in the integrity of the particular individuals who control the institution, the standard fidelity bonds written for financial institutions provide that they terminate immediately if the institution is taken over by some third party. The bond at-issue here, which is a standard form document, provides that it terminates immediately if GSC is taken over by another business entity, by state officials, by federal officials, or by a receiver or other liquidator.

The critical importance of the automatic termination upon takeover provision is facially apparent. No insurer is willing to underwrite the honesty of strangers. As the courts have recognized, once the institution has been taken over by third parties the risk which formed the basis of the agreement has been fundamentally and drastically altered.[1] To require those who issue fidelity bonds to insure the honesty of unknown third parties is to impose upon them a substantial burden for which they did not contract, for which they did not bargain, and for which they received no consideration.

GSC was taken over by a liquidator. The lower courts have ruled that the express and unambiguous provision of the agreement, which states that the bond terminates immediately if the institution is taken over by (among others) a liquidator, is meaningless and unenforceable. They did so on the basis of a provision in the Securities Investors Protection Act ("SIPA") which incorporates, wholesale, the procedures of the Bankruptcy Code when a securities dealer is liquidated. A substantive, not procedural, provision of the Bankruptcy Code, known as the "anti-ipso-facto" provision, states that a liquidator may enforce an agreement "notwithstanding any provision . . . conditioned on the insolvency or financial condition of the debtor . . . or on the appointment of or taking possession by a trustee . . . that effects . . . a termination of the debtor's property."[2]

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[1] *Sharp v. FSLIC*, 858 F.2d 1042, 1045-46 (5th Cir. 1988).

[2] 11 U.S.C. § 541(c)(1)(B).

Congress has never spoken on the enforceability of the automatic termination provision with specific reference to a securities dealer's fidelity bond. Long after SIPA was enacted in 1970, however, Congress did speak to the issue in the case of banks and savings and loans. In 1989, Congress closely focused on the issue of financial institution liquidation and enacted legislation establishing detailed procedures rather than, as SIPA had done, simply incorporate bankruptcy procedures. The legislation included an "anti-ipso-facto" provision, like that in the Bankruptcy Code, which states that a bank or savings and loan liquidator "may enforce any contract . . . notwithstanding any provision . . . for termination . . . by reason of insolvency or the appointment of a [liquidator].[3] Congress expressly excepted, however, fidelity bonds from the class of contracts that liquidators may enforce notwithstanding automatic termination provisions.[4]

Standard form fidelity bonds, which include the automatic termination upon takeover provision, predate SIPA and other federal statutes that regulate the financial services industry. Congress required financial institutions to purchase standard form fidelity bonds with full knowledge they provided for automatic termination upon takeover. The automatic termination provision is a valuable contract right held by those who issue fidelity bonds.

Freedom of contract and the enforcement of lawful contracts are matters of paramount public importance. Courts may not interfere with the performance of lawful

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[3] 12 U.S.C. § 1821(e)(12)(A).

[4] *Ibid.*

contracts in the absence of clear, explicit, well-defined, and dominant authority. Article I, section 10 of the Constitution prohibits states from impairing the obligation of contracts. It has been held that the Fifth Amendment's prohibition of taking property for public use without due process or just compensation embraces this principle with regard to actions of the federal government.

When SIPC stripped National Union of its lawful contractual termination rights, it took National Union's property as surely as if it had seized the insurer's real property. This taking without just compensation violates the Fifth Amendment.

II. ARGUMENT

A. NO AUTHORITY JUSTIFIES INVALIDATION OF THE AUTOMATIC TERMINATION PROVISION

In *St. Paul Mercury Ins. Co. v. Duke University*, 849 F.2d 133, 135 (4th Cir. 1988) the court observed that "our commercial system depends on the ability of parties to contract with certainty. Were courts free to refuse to enforce contracts as written on the basis of their own conceptions of the public good, the parties to contracts would be left to guess at the content of their bargains, and the stability of commercial relations would be jeopardized."

Nearly a century ago the Court recognized that "the usual and most important function of courts of justice is to maintain and enforce contracts rather than to enable parties thereto to escape from their obligations on the

pretext of public policy, unless it clearly appear that they contravene public right or the public welfare . . . [Y]ou have this paramount public policy to consider, – that you are not lightly to interfere with this freedom of contract."[5] "Public policy is to be ascertained by reference to the laws and legal precedents . . . there must be found definite indications in the law of the sovereignty to justify the invalidation of a contract as contrary to that policy. It is a matter of public importance that good faith contracts of the United States should not be lightly invalidated. Only dominant public policy would justify such action."[6]

Here the lower court invalidated the automatic termination provision on statutory rather than public policy grounds, but the same general considerations apply. The bond is a good faith and lawful contract between National Union and GSC. It is a standard form fidelity bond that is required by the federal government (including the automatic termination provision) (15 U.S.C. § 78iii, NASD ¶¶ 2182, 2182A; 12 C.F.R. § 563.19), both for securities dealers and for other financial institutions.

Because the bond is a lawful contract, which National Union reasonably believed would be enforced according to its terms, and which in a very real sense bears the

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[5] *Baltimore & Ohio Southwestern Ry. v. Voigt*, 176 U.S. 498, 505-06 (1900) (citation and internal quotation omitted).

[6] *Muschany v. United States*, 324 U.S. 49, 66 (1945). *See also United Paperworkers International Union v. Misco, Inc.*, 484 U.S. 29, 42 (1987); *W.R. Grace & Co. v. Rubber Workers*, 461 U.S. 757, 766 (1983); *Sabine Corp. v. Ong Western, Inc.*, 725 F.Supp. 1157, 1183 (W.D. Okla. 1989).

imprimatur of the federal government, a critical provision of the bond may not be invalidated on statutory grounds unless the statute on which the court bases its authority clearly, and in a well-defined and explicit manner, applies to the contractual provision at-issue. It cannot reasonably be said that the statutes relied upon by the lower courts here were clearly and explicitly intended by Congress to invalidate an automatic termination upon takeover provision in a standard fidelity bond.

As petitioner has shown, the courts have upheld the enforceability of the automatic termination provision in the context of fidelity bonds written for banks and savings and loans.[7] Petitioner has discussed a principal basis for these decisions; the federal government has required these institutions to purchase a standard form bond that includes an automatic termination provision. As the Ninth Circuit found: "[W]e conclude that the Form 22 bond, with all of its provisions [including the automatic termination provision], is endorsed by the federal government by way of the federal agency responsible for the regulation of the savings and loan industry . . . through its requirement that the Standard Form 22 bond be used."[8]

Federal regulation of consumer protection in the securities field parallels (albeit with less direct federal intervention) the statutory scheme established for banks

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[7] Petition at 12-17.

[8] *California Union Ins. v. American Diversified Sav.*, 948 F.2d 556, 562 (9th Cir. 1991). *See also Sharp*, 858 F.2d at 1043.

and savings and loan associations. SIPA created the Securities Investor Protection Corporation ("SIPC") which, like the Federal Deposit Insurance Corporation ("FDIC") and the late FSLIC, insures customers against loss if a financial institution, and in the case of SIPC a securities dealer, fails.[9]

Congress gave SIPC oversight authority to regulate securities dealers.[10] Direct responsibility was given to self-regulatory organizations, such as the National Association of Securities Dealers ("NASD"); however SIPC's mandate was to consult and cooperate with self-regulatory organizations for the purpose of establishing and implementing procedures to monitor the activities of securities dealers, and to insure their compliance with applicable financial responsibility rules.[11]

As established by petitioner, NASD, as a body empowered by Congress to regulate securities dealers, required GSC and its other SIPC-insured members to purchase "a blanket fidelity bond, in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America."[12] Thus, the Ninth Circuit's holding in *California Union Ins. v. American Diversified Sav.*, 948 F.2d 556 (9th Cir. 1991) fairly may be adapted to the circumstances present here:

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[9] *See Securities Investor Protection Corporation v. Barbour*, 421 U.S. 412 (1975); *Securities Investor Protection Corporation v. Vigman*, 803 F.2d 1513 (9th Cir. 1986).

[10] 15 U.S.C. § 78iii.

[11] *Ibid.*

[12] Petition at 10-11.

> [W]e conclude that the [standard form Brokers Blanket Bond], with all of its provisions [including the automatic termination provision], is endorsed by the federal government by way of the federal agency responsible for the regulation of the [securities dealer] industry . . . through its requirement that the [standard form Brokers Blanket bond] be used.[13]

There is another important reason that the courts have upheld automatic termination provisions in financial institution fidelity bonds. When Congress focused carefully on the issue of liquidation and fidelity bond termination provisions, long after the enactment of SIPA, it determined that automatic termination provisions are enforceable and that liquidators may not seek to invalidate them.

Congress enacted detailed procedures for liquidating banks and savings and loans, and specified with great particularity the authority of liquidators.[14] Congress gave liquidators appointed by the Resolution Trust Corporation broad authority to void limiting provisions in certain contracts, but explicitly denied authority to void coverage-limiting provisions in fidelity bonds:

> The conservator or receiver may enforce any contract, *other than a . . . depository institution bond*, entered into by the depository institution notwithstanding any provision of the contract providing for termination, default, acceleration, or exercise of rights upon, or solely by reason of,

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[13] *California Union*, 948 F.2d at 562 (as adapted).

[14] *See* 12 U.S.C. §§ 1821 *et seq.* and enabling regulations.

> insolvency or the appointment of a conservator or receiver.[15]

The courts have held this statutory language shows Congress was aware that financial institutions had obtained fidelity bonds limiting coverage in the event of a takeover, yet specifically excluded such bonds from section 1821's "anti-ipso-facto" provision:

> Continuance of [fidelity bond coverage] after seizure of a bank by FDIC has not been a major concern of the government. It is clear from [12 U.S.C.] § 1828 that Congress is aware of fidelity insurance and could, if it so desired, set terms which would avoid the problem presented by [the automatic termination provision]. *Congress chose to specifically exclude fidelity insurance from the prohibition contained in the new section 1821(e)(12)(A).*[16]

The Ninth Circuit has said that section 1821(e)(12)(A) is

> evidence of *Congress' approval of the termination provisions found in the Standard Form 22 bonds. . . .* We view this amendment [excepting fidelity bonds from the government's anti-ipso-facto powers] as *recognition of a public policy permitting this termination of . . . bond coverage upon takeover* by the government of the failed thrift.[17]

Congress has both expressly and impliedly required financial institutions to purchase standard form fidelity

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[15] 12 U.S.C. § 1821(e)(12)(A) (emphasis supplied).

[16] *FDIC v. Aetna Casualty and Surety Co.*, 903 F.2d 1073, 1077 (6th Cir. 1990) (emphasis supplied).

[17] *California Union*, 948 F.2d at 562-63 (emphasis supplied).

bonds, with full knowledge that the bonds provide for immediate termination upon takeover by a liquidator. Congress has expressed a public policy favoring automatic termination of coverage upon takeover by a liquidator in the savings and loan context. Thus, the issue is reduced to this: Does SIPA's wholesale adoption of bankruptcy procedures for the liquidation of a securities dealer override the focused and considered judgment of Congress favoring the automatic termination upon takeover provision of a standard fidelity bond?

SIPA simply provides that "[t]o the extent consistent with the provisions of [SIPA], a [SIPA] liquidation proceeding shall be *conducted* in accordance with, and as though it were being *conducted* under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of [the Bankruptcy Code.]"[18] The Court of Appeal's conclusion that this provision incorporates into SIPA every substantive provision of the referenced chapters and subchapters of the Bankruptcy Code cannot be supported. "The reorganization procedures of the [Bankruptcy Code] were adopted [by SIPA] to give the trustee the maximum flexibility in managing the affairs of the broker/dealer pending liquidation."[19] Thus, 15 U.S.C. § 78fff(b) was intended by Congress only

> to make the flexible [Bankruptcy Code] *procedures* available for SIPA liquidations. This does not mean that every provision of the [Bankruptcy Code], including provisions not relating

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[18] 15 U.S.C. § 78fff(b) (emphasis supplied).

[19] Statement of Senator Bennett, 116 Cong. Rec. 40905 (December 10, 1970).

> to procedures for the operation of a bankrupt, has been incorporated into the SIPA. *Only those provisions relating to* the *procedures* for conducting the affairs of the estate during bankruptcy administration, except as inconsistent with the provisions of SIPA, have been incorporated.[20]

By no stretch of the imagination can the Bankruptcy Code's anti-ipso-facto provision, 11 U.S.C. § 541(c)(1)(B), be considered a procedural provision governing the conduct of a liquidation proceeding under SIPA. It profoundly affects the substantive rights of parties who enter into lawful and good faith contracts.

SIPA states that Bankruptcy Code procedures *are* incorporated only to the extent they are consistent with SIPA. The government has consistently approved and required fidelity bonds that terminate automatically upon takeover, both under SIPA and under statutes governing other financial institutions. SIPA's requirement of consistency refutes any suggestion that SIPA incorporates the Bankruptcy Code's anti-ipso-facto provision, which is inconsistent with SIPA, and demonstrates beyond question that there is no dominant public policy favoring invalidation of the automatic termination provision.

Moreover, even if we assume, for the purpose of argument, that SIPA incorporates 11 U.S.C. § 541(c)(1)(B), that is scarcely sufficient to invalidate the automatic termination provision in a government-approved fidelity bond.

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[20] *S.E.C. v. Aberdeen Securities Co., Inc.*, 526 F.2d 603, 606 (3d. Cir. 1975) (emphasis supplied in the last sentence).

The following are typical applications of the Bankruptcy Code's anti-ipso-facto provision. *In re Bell*, 700 F.2d 1053 (6th Cir. 1983) involved a debtor who borrowed to purchase a van. The loan agreement provided that the lender was entitled to immediately repossess the van if the borrower filed for bankruptcy.[21] The court said the provision was inoperative under section 541(c)(1)(B) and the van became the property of the estate (until abandoned by the estate).[22] Similarly, *In re Winters*, 69 B.R. 145 (D. Ore. 1986) and *Matter of Bryant*, 43 B.R. 189 (E.D. Mich. 1984) found that a secured creditor's attempt to repossess property pursuant to a bankruptcy clause in the lending agreement is barred by the anti-ipso-facto clause.[23]

In *United Counties Trust Co. v. Knapp*, 137 B.R. 582 (D. N.J. 1992) plaintiff, who had issued a credit card to Knapp, attempted to revoke permission to use the card when Knapp filed for bankruptcy. Charges made after the revocation letter were, plaintiff argued, fraudulent and thus nondischargeable. The court rejected plaintiff's argument, finding the revocation ineffective pursuant to section 541(c)(1)(B).[24] In *Mumpfield v. Leavell*, 140 B.R. 578 (M.D. Ala. 1991) the debtor had entered into a contract to purchase real property. The seller's attempt to terminate the agreement was held by the bankruptcy court to be "a

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[21] *Id.* at 1258.

[22] *Ibid.*

[23] *See also In re Mitchell*, 85 B.R. 504 (D. Nev. 1988) (same).

[24] *Id.* at 585-86.

forfeiture under the terms of the agreement" and thus contrary to the anti-ipso-facto provision.[25]

These are the sort of agreements that the anti-ipso facto provision of the Bankruptcy Code was intended to reach. Typically the debtor has an existing (usually possessory) interest in property; someone else, who has a contingent interest (usually upon default) seeks to bypass the bankruptcy estate and transfer that property interest from the debtor to himself. Without the anti-ipso-facto provision, it would be difficult for many who are insolvent to reorganize. A hardware store owner would have a difficult time getting a fresh start if his landlord could cancel the lease and his delivery trucks could be repossessed.

A fidelity bond simply is not that sort of contract. The bond here, which is a standard form bond, may be terminated in a number of ways. It terminates upon expiration of the bond period, upon written notice by the insurer, upon written request by the insured, upon takeover of the insured by another business entity, and upon takeover of the insured by a receiver or other liquidator or by state or federal officials. Here the focus is on takeover, not insolvency.

The bond covers only losses discovered during the bond period; that is, after the effective date of the bond and prior to termination. Thus, National Union would have been obligated to pay a fidelity loss discovered during its bond period even though the dishonest act occurred before the effective date of the bond. By the

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[25] *Id.* at 580-81.

same token, if the trustee had purchased a fidelity bond for the period of the trusteeship, as he was authorized to do (see 11 U.S.C. § 322; Bankruptcy Rule 2010(a)), then the loss at issue here (which was discovered after the appointment of the trustee) would have been covered under the trustee's bond. The trustee chose not to insure against this risk. The consequences of his choice cannot be imposed equitably upon National Union.

The insured has *no* property interest in any bond proceeds unless a loss is discovered prior to termination. This bond terminated immediately, in accordance with its express terms, when the insured was taken over. GSC did not and could not have had any property interest under the bond for losses discovered after takeover.

The point is illustrated by *Continental Cas. Co. v. Allen*, 710 F.Supp. 1088 (N.D. Tex. 1989). There, the insurer issued a directors' and officers' ("D&O") liability policy to a bank. The policy excluded claims brought by FDIC as a receiver, conservator, or liquidator. (Congress expressly excluded D&O policies, as it did fidelity bonds, from the anti-ipso-facto provision contained in the legislation governing liquidation of banks and savings and loan associations. 12 U.S.C. § 1821(e)(12)(A).) FDIC took over the bank as receiver and liquidator and sued its directors; it challenged the enforceability of the exclusion, claiming that it violated FDIC's "statutory right to marshal and collect assets."[26] The court disagreed:

> FDIC overlooks the very important fact that in order to marshal and collect an asset, the failed

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[26] *Continental Cas. Co.*, 710 F.Supp. at 1099.

> bank must have it as an asset. Here, the bank did not own as an asset directors' and officers' liability insurance without an FDIC [exclusion].[27]

Similarly, GSC did not own as an asset a fidelity bond without an automatic termination upon takeover provision. The provision was triggered immediately upon SIPC's takeover of GSC. From that point forward, GSC had *no* property interest in the bond or its proceeds; there simply was nothing that could have transferred to the estate.

In short: (1) Congress has required the use of a bond containing an automatic termination provision and SIPC cannot complain about its enforceability; (2) when Congress spoke on fidelity bond automatic termination provisions, it declared them enforceable in liquidation proceedings; (3) it is reasonable to infer that had Congress focused on the issue in the context of SIPC proceedings, it would have reached the same conclusion that it did with respect to FDIC and FSLIC proceedings; (4) in light of the "general rule . . . that competent persons shall have the utmost liberty of contracting and that their agreements voluntarily and fairly made shall be held valid and enforced by the courts,"[28] SIPA's wholesale adoption of bankruptcy procedures cannot invalidate substantive rights of contracting parties; (5) Congress did not intend to, and did not, incorporate the Bankruptcy Code's anti-ipso-facto provision into SIPA liquidation

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[27] *Id.* at 1099-1100.

[28] *Twin City Pipe Line Co. v. Harding Glass Co.*, 283 U.S. 353, 356 (1931).

proceedings; and (6) even if it had, the provision would not apply to the automatic termination provision in a Securities Dealer Blanket Bond.

For all of these reasons, the lower courts erred in ruling that the automatic termination provision of the Securities Dealer Blanket Bond is invalid and unenforceable. The lower courts have, by judicial ukase, required National Union to provide coverage for a loss which is not, under the express and unambiguous terms of the bond, a covered loss. This constitutes a taking of National Union's property in violation of the Fifth Amendment.

B. THE LOWER COURT'S RULING VIOLATES THE FIFTH AMENDMENT

The Fifth Amendment of the Constitution embraces the principle, articulated with respect to states in Article I, section 10, that the federal government may not arbitrarily impair contractual rights. "[A] flagrant impairment of contract by a federal governmental body would be forbidden by the due process clause of the fifth amendment of the United States Constitution."[29] "[A] measure of protection against contract impairment is given by the Fifth Amendment."[30]

"The Fifth Amendment commands that property be not taken without just compensation. Valid contracts are property, whether the obligor be a private individual, a

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[29] *Armstrong v. Fairmont Community Hosp. Assoc., Inc.*, 659 F.Supp. 1524 (D. Minn. 1987).

[30] *John McShain, Inc. v. District of Columbia*, 205 F.2d 882 (D.C. Cir. 1953), *cert. denied* 346 U.S. 900.

municipality, a State or the United States."[31] An executory contract is "property within the meaning of the Fifth Amendment."[32]

"The essence of every executory contract is the obligation which the law imposes on the parties to perform it. It [the contract] may be defined to be a transaction between two or more persons, in which each party comes under an obligation to the other, and each reciprocally acquires a right to whatever is promised by the other."[33] These contractual rights come "within [the Fifth Amendment's] protection."[34] Thus, if the federal government takes a valuable contract right, it must pay just compensation.[35]

Contract rights acquired by National Union were the agreement that the bond will terminate immediately upon takeover, and that National Union shall not be liable for any loss discovered after termination. If the federal government took these valuable rights for public use, National Union is entitled to just compensation.

The acts of SIPC plainly constitute acts of the federal government. SIPC was established by, and derives its

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[31] *Lynch v. United States*, 292 U.S. 571, 579 (1934). *See also Far West Federal v. Office of Thrift Supervision*, 746 F.Supp. 1042, 1049 (D. Ore. 1990).

[32] *Omnio Commercial Co., Inc. v. United States*, 261 U.S. 502, 507 (1923).

[33] *Id.* at 510.

[34] *Johnson v. United States*, 79 F.Supp. 208, 211 (Ct. C1. 1948).

[35] *Monongahela Navigation Co. v. United States*, 148 U.S. 312 (1893).

powers from, Congress.[36] When a corporation is created in accordance with, and in furtherance of, federal legislation, and is subject to the control of the federal government, its conduct constitutes "state action" and is subject to constitutional limitations.[37] When SIPC brought this action to take away National Union's contractual termination rights, it did so as an agent of the federal government.

It also is clear that this was a taking for public use. SIPC was created to further SIPA's purpose: "to protect against individual hardship caused to customers of brokerage houses by broker failures, to restore investor confidence, and to upgrade the financial responsibility required of registered brokers and dealers."[38] SIPA was enacted for this reason:

> The serious and persistent financial problems besetting the securities industry in recent months have led to the voluntary liquidations, mergers, receiverships or, less frequently, bankruptcies of a substantial number of brokerage houses. Such failures may lead to loss of customers' funds and securities with an inevitable weakening of confidence in the U.S. securities markets. Such lessened confidence has an effect on the entire economy.[39]

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[36] 15 U.S.C. § 78ccc.

[37] *Mathis v. Opportunities Indust. Centers, Inc.*, 545 F.2d 97, 98 (9th Cir. 1976).

[38] *S.E.C. v. White & Co., Inc.*, 546 F.2d 789 (8th Cir. 1976). *See also Securities Investor Protection Corp. v. Barbour*, 421 U.S. 412 (1975).

[39] H.R. Rep. No. 91-1613, 91st Cong., 2d Sess. 1 (1970).

To achieve its goal of strengthening confidence in the securities markets and avoiding adverse effects on the entire economy, Congress established SIPC for the purpose of, among other things, insuring "public customers" from loss "in the event of the financial insolvency of their broker."[40] These insurance proceeds are to be paid, if necessary, from a fund established by SIPA and administered by SIPC.[41]

The SIPC fund, which is backed by authority to borrow $1 billion from the U.S. Treasury, is funded by SIPC member assessments.[42] SIPC is required by law to maintain in its fund an aggregate balance of at least $75 million.[43] The fund no doubt has ample assets to meet its obligations to the customers of GSC.

By seeking to invalidate the automatic termination provision and force National Union to cover losses discovered after takeover, in derogation of the express language of the fidelity bond and the intent of the contracting parties, SIPC attempts to use the assets of National Union to pay customer losses that otherwise would be paid from the SIPC fund. A judgment has been entered in favor of the SIPC trustee, and against National Union, in the amount of $500,000. In a very real sense, this action is an effort by SIPC to transfer this amount from National Union to itself.

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[40] *Ibid.*

[41] *Ibid.*; 15 U.S.C. §§ 78ddd, 78fff-2, 78fff-3, 78fff-4.

[42] 78 U.S.C. § 78ddd.

[43] *Ibid.*

The SIPC fund was created to pay customer losses in the event of the failure of a securities dealer, in the public interest. National Union's fidelity bond was not written for this purpose; to the contrary, it was written to protect the dealer from dishonest officers and employees. By invalidating the automatic termination provision, and thus forcing National Union to pay $500,000 for the performance of a function that Congress intended the SIPC fund to perform, SIPC has appropriated National Union's property for its very public use.

SIPC has taken National Union's property as surely as if SIPC had seized real property owned by National Union, sold it, and deposited the proceeds in the SIPC fund. National Union is entitled to just compensation.

III. CONCLUSION

For the foregoing reasons, the decisions of the lower courts should be reversed.

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Respectfully submitted,

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